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TAGS: ECON EFIN ETRD PREL TH
SUBJECT: MEGAPROJECTS: WE KNOW WHY, NOBODY KNOWS HOW

REF: BANGKOK 1266

1.(SBU) Summary. The economic centerpiece of Prime Minister Thaksin's second term is a series of major infrastructure projects estimated to cost US$57.5 billion over five years. It remains unclear how the RTG will finance these projects given self-imposed fiscal constraints, previous projects that disadvantaged private investors and an illiquid bond market. Given the importance Thaksin attaches to these projects, we expect he will engineer a formula to try and attract financing without any government guarantee of repayment. Whether he actually convinces enough investors to put their money where the PM's mouth is must await specifics. End Summary.

"COMMITTED PROJECTS" NOT A PROBLEM

2.(SBU) As reported previously (reftel), the Thaksin government has announced plans to undertake massive infrastructure expansion and modernization projects estimated to cost Bt2.35 trillion (US$57.5 billion) over the next five years. The total RTG budget for FY2005 is about Bt1.2 trillion (US$30.8 billion) and 2004 GDP was Bt6.6 trillion (US$169.3 billion). Projects the RTG describes as "committed" include the purchase of new aircraft by parastatal Thai Airways, rail links to the new Bangkok international airport and industrial development in the area around the airport, expansion of the existing Skytrain and subway lines, expansion of the highway system, expansion of the gas pipeline system and low-income housing development. Projects that are planned but "non-committed" include expansion of the railroad network, expansion and modernization of the water grid and development of a refinery and oil pipeline associated with the "land bridge" project across the Thai isthmus between the Andaman Sea and Gulf of T hailand.

WHY THE SUDDEN URGE TO SPLURGE

3.(SBU) The RTG has several goals in pursuing these ambitious "megaprojects." First, is to stimulate investment as the new driver to the Thai economy now that domestic consumption and export growth are leveling off. The second goal is to upgrade Thailand's infrastructure so that the country is better able to compete internationally. The stated intention is to reduce the cost of logistics in Thailand to less than 10 percent of GDP from its current level of about 19 percent (U.S. and Japan figures are 10 and 11 percent respectively). It is also intended to improve worker productivity by reducing the amount of time Bangkokians spend commuting. In the aftermath of the 1997-1998 financial crisis, little new public infrastructure investment has been made. Finally, in keeping with Thaksin's self-image as Thailand's CEO, he views the on-going excess liquidity in the banking sector (estimated to be Bt200-300 billion -US$5.1-7.7 billion) as an under-utilized asset that should be mobilized.

FISCAL POLICY TO REMAIN CONSERVATIVE

4.(SBU) The RTG does not intend to pay for these projects out of current budget expenditures or by increasing the net debt on the government's balance sheet. "Fiscal sustainability" is the government's watchword: defined, in part, as a maximum public debt/GDP ratio of less than 50 percent (currently about 47.9 percent - down from 52.9 percent in January 2002 - with an RTG goal of reducing this number to 40 percent by 2009), a balanced budget and debt service comprising less than 15 percent of the yearly RTG budget. With additional calls on the budget ranging from increasing the salaries of low-paid civil servants to tsunami and drought relief efforts to expenditures related to quelling the separatist movement in the south, there is little room in the RTG budget to finance the megaprojects and within the defined fiscal limits even if the economy continues to grow at 6 percent each year.

SO HOW TO PAY FOR IT ALL?

5.(SBU) The official capital-raising framework outlined by the Ministry Of Finance plans for 26 percent of the required capital to come from the government budget, 35 percent from State-owned enterprises (SOEs) and 39 percent from "other means such as securitisation or property development of areas adjacent to the projects." In fact, to bridge the apparent gap between fiscal rectitude and an investment binge, the Thaksin administration is studying a variety of approaches to keep these projects off the government books. First, many of the 'committed' projects will be undertaken by SOEs (Thai Airways, Airports of Thailand, PTT) that will finance the projects themselves either on the strength of their own balance sheets, through asset-backed financing or by forming joint ventures with private sector companies and/or financial institutions. Market observers seem confident that these established organizations can use the cash to be generated by the projects, backed by their other substantial assets, to secure proj
ect financing.

6.(SBU) For the mass transit expansion projects - extensions of the Skytrain, subway and toll roads - the RTG would like follow its previously successful method of granting long-term concessions (typically 25 years) to Special Purpose Vehicles - companies created specifically to build and operate these concessions. Existing examples of such entities are Bangkok Metro PCL - subways, Bangkok Expressway PCL - toll roads, and Bangkok Mass Transit PCL - Skytrain. These companies are typically joint ventures between leading Thai companies with the key foreign infrastructure suppliers (e.g. Siemens, Obiyashi) often taking an equity stake. The problem is that the equity investors in these projects have not done well. The RTG has limited the amounts the ventures may charge for their services (fares and tolls) and is currently trying to force operators of the Skytrain and subway to sell out to the mass transit regulatory authority at what the companies consider a low price. This history will make it very difficult to
convince new private investors to commit to any equity positions in the proposed projects.

7.(SBU) The most likely structure will be for the RTG to create "Public-Private partnerships", not-for-profit limited liability companies with initial capital provided by the government and granted a concession to built and operate a subway line or toll road or some other potential asset. These entities will issue bonds backed by the value of the anticipated future cash flow from its concession. There would be no RTG guarantee backing the debt.

BOND MARKET PROBLEMS

8.(SBU) There are several problems with this model. First, given the inherent risk of construction delays and over-runs, the debt will have to be very attractively priced (i.e. offer a high yield) in order to attract investors, especially in the absence of RTG backing. Second, if Bt2.3 trillion in new projects actually start-up over the next five years, in a domestic bond market which currently has severe liquidity problems and rising interest rates, the effect on corporate borrowing rates and crowding out effect could be severe. There is considerable skepticism among Thai market participants whether the domestic market has sufficient depth to absorb this much new paper. In November 2004, the total value of all outstanding bonds in Thailand was Bt2.74 trillion (US$70.3 billion) of which Bt2.51 trillion (US$64.4 billion) was either issued or backed by the RTG.

9.(SBU) Some observers posit that the RTG will provide the necessary capital to the PPPs with no effect on the RTG net debt level through the proceeds from IPOs of State-Owned Enterprises EGAT (electricity) and CAT and TOT (telecom) while also removing the government guarantee from the debt of these entities (thereby making room for new RTG debt to be issued under the debt/GDP cap). While this would be a start, the total of all RTG-guaranteed SOE bonds outstanding is only about Bt322 billion (US$8.3 billion); not enough even with the IPO proceeds to fund everything anticipated. Others point to the Asian Bond market initiative as a source of funds. There is no indication, however, that ASEAN central banks are interested in funding Thai infrastructure development, or even having more than a nominal exposure to Baht. This nascent effort for a pan-Asian debt market would have to develop much more quickly than it has to date in order to be a source of funds for the mega-projects

10.(SBU) COMMENT. We have spoken to money managers, bond market senior officials, academics and RTG officials responsible for managing government debt and designing some of the projects. None have been able to explain how the government will follow through on its seemingly contradictory promises of expanding investment while reducing debt. Most

are dubious it can be done, with some arguing that the entire exercise is designed to channel funds to Thaksin family and cronies (septel will examine the issue of corruption in Thailand - anecdotally it appears that large scale corruption may be getting worse while petty corruption may have marginally improved).

11.(SBU) The mega-projects are the single most important new plank in Thaksin's economic strategy for his second term. As an economist who helped design the "dual track" economic policy of Thaksin's first term told us, "Keynesian demand-led recovery is played out. We must move on to the next level for the economy to continue to grow." He continued: "In creating economic value, Thailand is ahead of China and about ten years behind Taiwan and Korea. We must maintain our pace to stay ahead of fast-moving China. We can't do that without significant new investment in infrastructure and improving human resources. I just don't know how we will pay for it." Although many here believe the PM's program is mostly talk and the majority of projects won't get off the ground, the Prime Minister's penchant for financial engineering means we cannot rule out a scheme that, at least on its face, gets the mega-projects underway. We suspect that Thaksin will be aggressively marketing portfolio investment in Thailand to foreigners
beginning with a planned visit to New York in June.

BOYCE